

Internal Revenue Service, Treasury

§ 1.181-1

- (3) Amount of recapture.
- (b) Recapture under section 1245.

§ 1.181-5 Examples.

§ 1.181-6 Effective/applicability date.

- (a) In general.
- (b) Pre-effective date productions.

[T.D. 9551, 76 FR 60724, Sept. 30, 2011, as amended by T.D. 9603, 77 FR 72924, Dec. 7, 2012]

§ 1.181-1 Deduction for qualified film and television production costs.

(a) *Deduction*—(1) *In general.* (i) An owner (as defined in paragraph (a)(2) of this section) of any film or television production (production, as defined in § 1.181-3(b)) that the owner reasonably expects will be, upon completion, a qualified film or television production (as defined in § 1.181-3(a)) may elect to treat production costs paid or incurred by that owner (subject to the limits imposed under paragraph (b) of this section) as an expense that is deductible for the taxable year in which the costs are paid (for an owner who uses the cash receipts and disbursements method of accounting) or incurred (for an owner who uses an accrual method of accounting). The deduction under section 181 is subject to recapture if the owner's expectations are later determined to be inaccurate.

(ii) This section provides rules for determining the owner of a production, the production costs (as defined in paragraph (a)(3) of this section), the maximum amount of aggregate production costs (as defined in paragraph (a)(4) of this section) that may be paid or incurred for a pre-amendment production (as defined in paragraph (a)(5) of this section) for which the owner makes an election under section 181, and the maximum amount of aggregate production costs that may be claimed as a deduction for a post-amendment production (as defined in paragraph (a)(6) of this section) for which the owner makes an election under section 181. Section 1.181-2 provides rules for making the election under section 181. Section 1.181-3 provides definitions and rules concerning qualified film and television productions. Section 1.181-4 provides special rules, including rules for recapture of the deduction. Section 1.181-5 provides examples of the appli-

cation of §§ 1.181-1 through 1.181-4, while § 1.181-6 provides the effective date of §§ 1.181-1 through 1.181-5.

(2) *Owner.* (i) For purposes of this section and §§ 1.181-2 through 1.181-6, an owner of a production is any person that is required under section 263A to capitalize the costs of producing the production into the cost basis of the production, or that would be required to do so if section 263A applied to that person.

(ii) Further, a person that acquires a finished or partially-finished production is treated as an owner of that production for purposes of this section and §§ 1.181-2 through 1.181-6, but only if the production is acquired prior to its initial release or broadcast (as defined in paragraph (a)(7) of this section). Moreover, a person that acquires only a limited license or right to exploit a production, or receives an interest or profit participation in a production, as compensation for services, is not an owner of the production for purposes of this section and §§ 1.181-2 through 1.181-6.

(3) *Production costs.* (i) For purposes of this section and §§ 1.181-2 through 1.181-6, the term *production costs* means all costs that are paid or incurred by an owner in producing a production that are required, absent the provisions of section 181, to be capitalized under section 263A, or that would be required to be capitalized if section 263A applied to the owner, and, if applicable, all costs that are paid or incurred by an owner in acquiring a production prior to its initial release or broadcast. Production costs include, but are not limited to, participations and residuals paid or incurred, compensation paid or incurred for services, compensation paid or incurred for property rights, non-compensation costs, and costs paid or incurred in connection with obtaining financing for the production (for example, premiums paid or incurred to obtain a completion bond for the production).

(ii) Production costs do not include costs paid or incurred to distribute or exploit a production (including advertising and print costs).

(iii) Production costs do not include the costs to prepare a new release or

new broadcast of an existing production after the initial release or broadcast of the production (for example, the preparation of a DVD release of a theatrically-released film, or the preparation of an edited version of a theatrically-released film for television broadcast). Costs paid or incurred to prepare a new release or a new broadcast of a production after its initial release or broadcast, therefore, are not taken into account for purposes of paragraph (b)(1) of this section, and may not be deducted under this paragraph (a).

(iv) If a pre-amendment production is acquired from any person prior to its initial release or broadcast, the acquiring person must use as its initial aggregate costs the greater of—

(A) The cost of acquisition; or

(B) The seller's aggregate production costs.

(v) Production costs do not include costs that the owner has deducted or begun to amortize prior to the taxable year the owner makes an election under § 1.181-2 for the production (for example, costs described in § 1.181-2(a)(2)). These costs, however, are included in aggregate production costs to the extent they would have been treated as production costs by the owner notwithstanding this paragraph (a)(3)(v).

(4) *Aggregate production costs.* The term *aggregate production costs* means all production costs described in paragraph (a)(3) of this section paid or incurred by any person, whether paid or incurred directly by an owner or indirectly on behalf of an owner.

(5) *Pre-amendment production.* The term *pre-amendment production* means a qualified film or television production commencing after October 22, 2004, and before January 1, 2008.

(6) *Post-amendment production.* The term *post-amendment production* means a qualified film or television production commencing on or after January 1, 2008.

(7) *Initial release or broadcast.* Solely for purposes of this section and §§ 1.181-2 through 1.181-6, the term *initial release or broadcast* means the first commercial exhibition or broadcast of a production to an audience. However, the term “initial release or broadcast”

does not include limited exhibition prior to commercial exhibition to general audiences if the limited exhibition is primarily for purposes of publicity, marketing to potential purchasers or distributors, determining the need for further production activity, or raising funds for the completion of production. For example, the term initial release or broadcast does not include exhibition to a test audience to determine the need for further production activity, or exhibition at a film festival for promotional purposes, if the exhibition precedes commercial exhibition to general audiences.

(8) *Special rule.* The provisions of this paragraph (a) apply notwithstanding the treatment of participations and residuals permitted under the income forecast method in section 167(g)(7)(D).

(b) *Limit on amount of aggregate production costs and amount of deduction—*

(1) *In general—(i) Pre-amendment production.* Except as provided under paragraph (b)(2) of this section, no deduction is allowed under section 181 for any pre-amendment production, the aggregate production costs of which exceed \$15,000,000. See also paragraph (a)(3)(iv) of this section. For a pre-amendment production for which the aggregate production costs do not exceed \$15,000,000 (or, if applicable under paragraph (b)(2) of this section, \$20,000,000), an owner may deduct under section 181 all of the production costs paid or incurred by that owner.

(ii) *Post-amendment production.* Section 181 permits a deduction for the first \$15,000,000 (or, if applicable under paragraph (b)(2) of this section, \$20,000,000) of the aggregate production costs of any post-amendment production.

(iii) *Special rules.* The owner's deduction under section 181 is limited to the owner's acquisition costs of the production plus any further production costs paid or incurred by the owner. The deduction under section 181 is not available for any portion of the acquisition costs, and any subsequent production costs, of a production with an initial release or broadcast that is prior to the date of acquisition.

(2) *Higher limit for productions in certain areas—(i) In general.* This section is applied by substituting \$20,000,000 for

\$15,000,000 in paragraph (b)(1) of this section for any production the aggregate production costs of which are significantly paid or incurred in an area eligible for designation as—

(A) A low income community under section 45D; or

(B) A distressed county or isolated area of distress by the Delta Regional Authority established under 7 U.S.C. section 2009aa-1.

(ii) *Significantly paid or incurred for live action productions.* The aggregate production costs of a live action production are significantly paid or incurred within one or more areas specified in paragraph (b)(2)(i) of this section if—

(A) At least 20 percent of the aggregate production costs paid or incurred in connection with first-unit principal photography for the production are paid or incurred in connection with first-unit principal photography that takes place in such areas; or

(B) At least 50 percent of the total number of days of first-unit principal photography for the production consists of days during which first-unit principal photography takes place in such areas.

(iii) *Significantly paid or incurred for animated productions.* For purposes of an animated production, the aggregate production costs of the production are significantly paid or incurred within one or more areas specified in paragraph (b)(2)(i) of this section if—

(A) At least 20 percent of the aggregate production costs paid or incurred in connection with keyframe animation, in-between animation, animation photography, and the recording of voice acting performances for the production are paid or incurred in connection with such activities that take place in such areas; or

(B) At least 50 percent of the total number of days of keyframe animation, in-between animation, animation photography, and the recording of voice acting performances for the production consists of days during which such activities take place in such areas.

(iv) *Significantly paid or incurred for productions incorporating both live action and animation.* For purposes of a production incorporating both live action and animation, the aggregate produc-

tion costs of the production are significantly paid or incurred within one or more areas specified in paragraph (b)(2)(i) of this section if—

(A) At least 20 percent of the aggregate production costs paid or incurred in connection with first-unit principal photography, keyframe animation, in-between animation, animation photography, and the recording of voice acting performances for the production are paid or incurred in connection with such activities that take place in such areas; or

(B) At least 50 percent of the total number of days of first-unit principal photography, keyframe animation, in-between animation, animation photography, and the recording of voice acting performances for the production consists of days during which such activities take place in such areas.

(v) *Establishing qualification.* An owner intending to utilize the higher aggregate production costs limit under this paragraph (b)(2) must establish qualification under this paragraph (b)(2).

(vi) *Allocation.* Solely for purposes of determining whether a production qualifies for the higher production cost limit (for pre-amendment productions) or deduction limit (for post-amendment productions) provided under this paragraph (b)(2), compensation to actors (as defined in §1.181-3(f)(1)), directors, producers, and other relevant production personnel (as defined in §1.181-3(f)(2)) is allocated entirely to first-unit principal photography.

(c) *Effect on depreciation or amortization of a qualified film or television production—*(1) *Pre-amendment production.* Except as provided in §§1.181-1(a)(3)(v) and 1.181-2(a)(2), an owner that elects to deduct production costs under section 181 for a pre-amendment production may not deduct production costs for that production under any provision of the Internal Revenue Code other than section 181 unless the recapture requirements of §1.181-4(a) apply to the production.

(2) *Post-amendment production.* Amounts not allowable as a deduction under section 181 for a post-amendment

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production may be deducted under any other applicable provision of the Code.

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§ 1.181-2 Election to deduct production costs.

(a) *Election*—(1) *In general*. Except as provided in paragraph (a)(2) of this section, an owner may make an election under section 181 to deduct production costs of a production only if that owner has not deducted in a previous taxable year any production costs for that production under any provision of the Internal Revenue Code (Code) other than section 181.

(2) *Exception*. An owner may make an election under section 181 despite prior deductions under any other provision of the Code for amortization of the costs of acquiring or developing screenplays, scripts, story outlines, motion picture production rights to books and plays, and other similar properties for purposes of potential future development or production of a production, if such costs were paid or incurred before the first taxable year for which an election may be made under § 1.181-2(b) and are included in aggregate production costs.

(b) *Time of making election*—(1) *In general*. The election to deduct production costs for a production under section 181 must be made by the due date (including any extension) for filing the owner's Federal income tax return for the first taxable year in which:

(i) Any aggregate production costs have been paid or incurred;

(ii) The owner reasonably expects (based on all of the facts and circumstances) that the production will be set for production and will, upon completion, be a qualified film or television production; and

(iii) For any pre-amendment production, the owner reasonably expects (based on all of the facts and circumstances) that the aggregate production costs paid or incurred for the pre-amendment production will, at no time, exceed the applicable aggregate production costs limit set forth under § 1.181-1(b)(1)(i) or (b)(2).

(2) *Special rule*. If paragraph (b)(1) of this section is not satisfied until a tax-

able year subsequent to the taxable year in which any aggregate production costs were first paid or incurred, the owner must make the election for the taxable year in which paragraph (b)(1) of this section is first satisfied, and any production costs paid or incurred prior to the taxable year in which the owner makes the election and not deducted in a prior taxable year are treated as production costs (except costs described in § 1.181-2(a)(2)) that are deductible under § 1.181-1(a)(1)(i) for the taxable year paragraph (b)(1) of this section is first satisfied and the election is made.

(3) *Six-month extension*. See § 301.9100-2 for a six-month extension of time to make the election in certain circumstances.

(c) *Manner of making election*—(1) *In general*. An owner must make the election under section 181 separately for each production. For a production owned by an entity, the election must be made by the entity. For example, if the production is owned by a partnership or S corporation, the partnership or S corporation must make the election.

(2) *Information required*—(i) *Initial election*. For each production to which the election applies, the owner must attach a statement to the owner's Federal income tax return for the taxable year of the election stating that the owner is making an election under section 181 and providing—

(A) The name (or other unique identifying designation) of the production;

(B) The date aggregate production costs were first paid or incurred for the production;

(C) The amount of aggregate production costs paid or incurred for the production during the taxable year (including costs described in §§ 1.181-1(a)(3)(v) and 1.181-2(b)(2));

(D) The amount of qualified compensation (as defined in § 1.181-3(d)) paid or incurred for the production during the taxable year (including costs described in § 1.181-2(b)(2));

(E) The amount of compensation (as defined in § 1.181-3(c)) paid or incurred for the production during the taxable year (including costs described in § 1.181-2(b)(2));